Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:SF:TL-N-5252-00; TL-N-2840-01
BAKranzthor

date: July 9, 2001

to: Associate Chief Counsel (Procedure and Administration)
Attn: Barbara Johnson, Technical Services Section, Room 4510

from: Area Counsel, Communications, Technology and Media

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subject: Nondocketed Significant Advice Review
[redacted]
Effect of "Partnership Item" Determination on Proposed Disguised Sale Adjustments

We recently orally advised LMSB Team Manager Ray Casabonne that certain proposed disguised sale adjustments required partnership level determinations. Due to the expiration of the statute of limitations applicable to tax attributable to adjustments of partnership items, such determinations are time-barred.

While prior formal National Office coordination was impractical, due to the audit team's desire for speedy advice, we did coordinate informally with Bill Heard (CC:PA:APJP:B03) on the general subject of "partnership items" before providing this advice. Ray Casabonne also contacted Ron Buch (CC:LM) informally, following Ron's recent IVT presentation on TEFRA. Ron's informal e-mail response is attached along with write-ups prepared by the agent and for the taxpayer.

AUDIT BACKGROUND

Exam is auditing [redacted], a closely held corporation controlled by the [redacted] family, and related corporate entities, for the taxable years [redacted]. The agent included as part of his audit a review of these corporations' Forms K-1 reflecting partnership distributions and allocations of partnership gains and losses.

Due to the age of the years under examination, consents were secured extending the corporations' statutes of limitation before the current audit team began its work. These consents did not, unfortunately, specifically extend the statute of limitations as to tax attributable to partnership items under Internal Revenue Code § 6229(b)(3). Nor were any consents secured pursuant to section 6229(b)(1). [redacted] we have advised Exam that where the statute of limitation on assessment for a corporation is open solely because of a consent pursuant to section 6501(c)(4) which does not expressly include tax

attributable to partnership items, the Service will not argue that section 6501(c)(4) nevertheless holds the statute open for tax attributable to partnership items.[1]

Accordingly, as a prerequisite to considering the substance of any of the issues set out below, we must determine to what extent, if any, the issues are based on adjustments to partnership items. To the extent the issues are based on adjustment to partnership items, the issues are time-barred. Although this memorandum is concerned only with determining to what extent the above issues are time-barred partnership items, not with analyzing the substantive merits of the issues themselves, some discussion of the underlying facts and of the substantive issues is required to make this determination. In the case of the [redacted] transaction, the underlying facts are complex, but the analysis of the "partnership item" issue is similar and fairly straightforward for both fact patterns.

FACTS – [redacted] TRANSACTION

[redacted] is a wholly owned subsidiary of [redacted]. In [redacted], [redacted] owned a [redacted]% general partnership interest in the [redacted]. On [redacted], [redacted] borrowed $[redacted] from unrelated entities. The loan was guaranteed by [redacted], but the guarantee was canceled on [redacted]. The loan agreement provided that one of the purposes of the loan was to allow [redacted] to make distributions to its partners. The loan agreement also said that [redacted] might merge into or otherwise combine with [redacted].

On [redacted], [redacted] transferred its [redacted]% general partnership interest in [redacted] to [redacted] in exchange for a [redacted]% general partnership interest in [redacted]. The final K-1 for [redacted] for the year ended [redacted] showed distributions to [redacted] of $[redacted] and to other partners (all related entities) of an additional $[redacted]. [redacted] was shown as liable for the entire [redacted] partnership debt of $[redacted] (which included the entire $[redacted] borrowed in [redacted]). After making the exchange of partnership interests, [redacted] was only liable for [redacted]% of the liabilities of [redacted].

[redacted] treated [redacted]'s transfer of the [redacted] interest to [redacted] as a contribution under Internal Revenue Code § 721.

LEGAL ANALYSIS – [redacted] TRANSACTION

ISSUE (1) [redacted] transferred its interest in [redacted] to [redacted]

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[1] [redacted] (b)(5)(AWP), (b)(7)a (b)(5)(AWP), (b)(7)a (b)(5)(AWP), (b)(7).

([redacted]). Is the possible application of Internal Revenue Code section 707(a)(2)(B) to this transfer a partnership item?

CONCLUSION (1) Yes; since [redacted] did not treat this transaction as a disguised sale, the Service cannot determine that the transaction is a disguised sale in a partner-level audit.

Under section 707(a)(2)(B), the "disguised sale" provisions, a transfer of property to a partnership can be treated as a sale (rather than as a contribution) where the partner receives in return cash or other property in addition to an interest in the partnership. Under section 752, when a partner contributes encumbered property to a partnership, if the partner's share of the encumbrance in the hands of the partnership is less than it was in his hands before the contribution, then in general the net decrease in the partner's liability is treated as a distribution of cash.

Since such a deemed distribution of cash can trigger a section 707(a)(2)(B) disguised sale, the regulations under section 707 define the circumstances under which relief of liability causes a transaction to be treated as a disguised sale. To this end, the regulations define and distinguish between "qualified" liabilities and liabilities that are not qualified. In general, the relief of qualified liabilities does not trigger disguised sale treatment.

Treas. Reg. § 1.707-5(a)(6) defines four categories of qualified liabilities:

(A) liabilities over two years old;

(B) liabilities less than two years old which were not incurred in anticipation of the transfer of the encumbered property to the partnership;

(C) liabilities incurred to purchase or improve the property;

(D) liabilities incurred in the ordinary course of business in which the transferred property was used, but only if all the assets related to the business are transferred along with the encumbered property.

Treas. Reg. § 1.707-5(a)(7) further provides that liabilities less than two years old that do not fall into the categories (C) or (D) above are presumed to be incurred in anticipation of the transfer; in other words, to be unqualified.

The agent and the taxpayer agree that the $[redacted] of the $[redacted] liability is not described by categories (A), (C), or (D). The agent looked to the language in the loan agreement that specifically mentioned distributions to partners as one of the allowed uses of the loan funds and the reference to the possible merger with [redacted] to conclude that $[redacted] of the $[redacted] liability was unqualified.

The taxpayer initially responded with two arguments: (1) the liabilities of [redacted]

are not the liabilities of [redacted], so the transfer to the [redacted] interest to [redacted] is not a relief of [redacted]'s liability; and (2) even if it is so treated, the entire $[redacted] is qualified liability because it was not incurred in anticipation of the transfer to [redacted].

After the parties discussed the issue in these terms, the taxpayer brought up the more basic question of whether the entire disguised sale issue is time-barred under the TEFRA provisions. If the determination of the character of the $[redacted] liability as qualified or not under Treas. Reg. § 1.707-5(a)(6) is a "partnership item," then the other issues are moot.

Definition of a "partnership item"

Internal Revenue Code § 6221 requires the tax treatment of any partnership item to be determined at the partnership level. Internal Revenue Code § 6231 provides the following definition:

> (a)(3) PARTNERSHIP ITEM.--The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

Treas. Reg. § 301.6231(a)(3)-1(a) lists and describes items which are required to be taken into account for the taxable year of a partnership and are more appropriately determined at the partnership level than at the partner level; therefore, these items are partnership items:

> . . . (4) Items relating to the following transactions, to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership, for purposes of the partnership books and records or for purposes of furnishing information to a partner:
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> (i) Contributions to the partnership;
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> (ii) Distributions from the partnership; and
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> (iii) Transactions to which section 707(a) applies (including the application of section 707(b)).

Treas. Reg. § 301.6231(a)(3)-1(b) provides this general direction:

> The term "partnership item" includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc.

Treas. Reg. § 301.6231(a)(3)-1(c)(2) provides illustrations of what the partnership needs to determine with respect to contributions to the partnership:

(i) The character of the amount received from a partner (for example, whether it is a contribution, a loan, or a repayment of a loan);

(ii) The amount of money contributed by a partner;

(iii) The applicability of the investment company rules of section 721(b) with respect to a contribution; and

(iv) The basis to the partnership of contributed property (including necessary preliminary determinations, such as the partner's basis in the contributed property).

To the extent that a determination of an item relating to a contribution can be made from these and similar determinations that the partnership is required to make, therefore, that item is a partnership item. To the extent that the determination requires other information, however, that item is not a partnership item. For example, it may be necessary to determine whether contribution of the property causes recapture by the contributing partner of the investment credit under section 47 in certain circumstances in which that determination is irrelevant to the partnership.

For disguised sales specifically, Treas. Reg. § 301.6231(a)(3)-1(c)(4) provides:

Transactions to which section 707(a) applies. For purposes of its books and records, the partnership needs to determine:

(i) The amount transferred from the partnership to a partner or from a partner to the partnership in any transaction to which section 707(a) applies;

(ii) The character of such an amount (for example, whether or not it is a loan; in the case of amounts paid over time for the purchase of an asset, what portion is interest); and

(iii) The percentage of the capital interests and profits interests in the partnership owned by each partner.

To the extent that a determination of an item relating to a transaction to which section 707(a) applies can be made from these and similar determinations that the partnership is required to make, therefore, that item is a partnership item. To the extent that that determination requires other information, however, that item is not a partnership item. An example of such other information is the cost to the partner of goods sold to the partnership.

Applying these provisions to the question of whether determining the character of [redacted]'s $[redacted] liability as qualified or not under Treas. Reg. § 1.707-5(a)(6) is a "partnership item" of [redacted], the agent points out that [redacted] has no information upon which to determine whether the [redacted] liability is qualified or not. He suggests, therefore, that the item is akin to the cost to the partner of goods sold to the partnership, which is cited as an example of a non-partnership item in Treas. Reg. § 301.6231(a)(3)-1(c)(4).

Access to information, however, is not determinative. As stated in Treas. Reg. § 301.6231(a)(3)-1(c)(1), "The critical element is that the partnership needs to make a determination with respect to a matter for the purposes stated." Under Treas. Reg.

§ 301.6231(a)(3)-1(c)(2)(i), when a partner transfers property to a partnership, the partnership needs to determine "[t]he character of the amount received from a partner (for example, whether it is a contribution, a loan, or a repayment of a loan)." Here [redacted] transferred property (its partnership interest in [redacted]) to [redacted] in exchange for a partnership interest in [redacted]. [redacted] must determine, therefore, whether [redacted]'s transfer of the [redacted] partnership interest is a contribution (to be treated under section 721(a)) or something else. The "something else" could be disguised sale under section 707(a)(2)(B), resulting in the very different treatment as a sale or exchange of a portion of the property along with treatment as a contribution for the remainder. [redacted] determined that [redacted]'s transfer of property was entirely a contribution. Since [redacted] was required to make this determination under Treas. Reg. § 301.6231(a)(3)-1(c)(2)(i), it was a partnership item and cannot be adjusted in a non-partnership proceeding.

This conclusion is supported by Treas. Reg. § 301.6231(a)(3)-1(c)(2)(iv), which provides that the partnership also needs to determine "[t]he basis to the partnership of contributed property (including necessary preliminary determinations, such as the partner's basis in the contributed property)." [redacted]'s basis in the property purportedly contributed by [redacted] depends upon whether the transaction is treated entirely as a contribution (in which case [redacted]'s basis will be determined under section 722 and, if applicable, section 752). [redacted]'s basis in the property transferred by [redacted] will be figured differently if the transaction constitutes a disguised sale under section 707(a)(2)(B). [redacted], therefore, in order to determine its basis in the property transferred by [redacted], is *required* to determine whether the disguised sale rules apply. To do that, [redacted] must determine whether [redacted]'s liabilities were qualified or unqualified. In other words, determining whether [redacted]'s liabilities were qualified or unqualified is a "necessary preliminary determination" analogous to determining "the partner's basis in the contributed property" under Treas. Reg. § 301.6231(a)(3)-1(c)(2)(iv).[2]

FACTS – THE [redacted] TRANSACTION

Three related corporate taxpayers held partnership interests in two limited partnerships, [redacted] ([redacted]) and [redacted] ([redacted]) (the Old Partnerships). The Old Partnerships were engaged in the [redacted], and the manufacture and sale of

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[2]A recent Field Service Advice determined that whether a series of partnership transactions constituted a disguised sale was a partnership item that should be included in the final partnership administrative adjustment. FSA 200049023 (9/6/00) (cites [redacted] (b)(5)(AWP), (b)(7)a (b)(5)(AWP), (b)(7)a (b)(5)(AWP), in which "the Tax Court noted without further inquiry that the parties agreed that the recharacterization [of contributions and distributions] issue was a partnership issue" in a disguised sale context). See also FSA 200051016 (9/12/00) (valuing partnership assets falls within the broad definition of partnership items in the regulations under section 6231).

[redacted] products. The fair market value of the assets of the Old Partnerships substantially exceeded their liabilities. The taxpayers and the other partners of the Old Partnerships wanted to combine the assets of the Old Partnerships, retain managerial control over the combined enterprise, bring in public investors, and receive cash in the approximate amount of their investment.

To accomplish these objectives, all of the partners of the Old Partnerships agreed to contribute their interests in the Old Partnerships to a newly formed partnership, [redacted] (the New Partnership) in exchange for interests in the New Partnership plus other property (almost exclusively cash). As part of the overall plan, limited partnership units representing [redacted]% of the New Partnership would be offered for sale to the public. According to the plan, the cash to be paid to the partners of the Old Partnerships would be obtained from a "Bridge Loan," which would be promptly repaid upon receiving the cash from the public investors. This entire plan (sometimes referred to as the "Transaction") was interdependent, so that, for example, if the public offering did not take place the interests in the Old Partnerships would not be transferred to the New Partnership.

The taxpayers and the other partners of the Old Partnerships recognized that this Transaction was a "disguised sale" under Internal Revenue Code § 707(a)(2)(B), so they attempted to structure the transaction to minimize the taxable gain that would be recognized pursuant to the regulations issued under section 707.

The Taxpayers

The related taxpayers under audit in this case are [redacted] ([redacted]), [redacted] ([redacted]), [redacted] ([redacted]), and [redacted] ([redacted]). [redacted] is a closely held C corporation owned by members of the [redacted] family. [redacted] is an [redacted]% owned subsidiary of [redacted]. [redacted] is a wholly owned subsidiary of [redacted] (thus a second tier subsidiary of [redacted]). [redacted], [redacted], and [redacted] are included in a consolidated return, [redacted], for the year ended [redacted]. [redacted] is an S corporation, also owned by members of the [redacted] family. These [redacted] family corporations collectively owned all the general and most (over [redacted]%) of the limited partnership interests of [redacted] and a substantial (but less than [redacted]%) portion of the partnership interests of [redacted]. [redacted] owned limited partnership interests in [redacted] only. [redacted] owned a limited partnership interest in [redacted] only. [redacted] owned [redacted]% of the general partnership interest and a limited partnership interest of [redacted]. [redacted] owned no interests in the Old Partnerships when these transactions were planned, but, according to the taxpayers, immediately before the Old Partnership interests were transferred to the New Partnership, [redacted] converted all but a nominal part of its general partnership interest in [redacted] to additional limited partnership interest and then contributed all its limited partnership interest in [redacted] to [redacted].

The Transaction

On [redacted], the New Partnership published an Offer Document in

which it offered to exchange interests in the New Partnership (sometimes referred to as Master Limited Partnership Units, or MLP Units) and other property (almost exclusively cash and "Special Allocation Units," or "SAUs"[3]) for interests in the Old Partnerships. The offer was accepted. As stated in the Offer Document, [redacted] and [redacted] received the following consideration in exchange for their limited partnership interests in the Old Partnerships:

T/p	Cash	MLP Units	SAUs
[redacted]	$[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]

The Offer Document provided that [redacted] would receive the following consideration in exchange for its general and limited partnership interests in [redacted]:

T/p	Cash	MLP Units	SAUs	[redacted][4]
[redacted]	$[redacted]	[redacted]	[redacted]	$[redacted]

According to the taxpayers, however, [redacted]'s last-minute conversion and contribution of [redacted] limited partnership interests to [redacted] meant that [redacted], not [redacted], was entitled to receive the cash, MLP Units and SAU's the offer had reserved for [redacted]. Furthermore, again according to the taxpayers, immediately after [redacted] received the contribution of the [redacted] limited partnership interest from [redacted] and immediately before the exchange of Old Partnership interests for New Partnership interests and other property, [redacted] received [redacted] property (valued at $[redacted] by the taxpayers) from [redacted] in partial liquidation of [redacted]'s newly acquired [redacted] limited partnership interest. Again according to the taxpayer, [redacted] (instead of [redacted]) received the above-listed cash, MLP units and SAU's from the New Partnership in exchange for [redacted]'s remaining [redacted] limited partnership interest after the alleged partial liquidation transaction.

The Offer Document explained the reason for the transfer of the [redacted] Property as follows:

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[3]An SAU represented a special right to participate in New Partnership distributions that were not available to the new investors who purchase MLP Units in the public offering. The purpose of the SAUs was to preserve for the partners of the Old Partnerships the profits from certain contracts that were thought to be particularly favorable. The special participation rights under the SAUs expired on [redacted]. This expectation of special distributions under the SAUs was not realized, but at the time of the transaction, the taxpayers valued the SAUs at $[redacted] apiece.

[4][redacted] acres, previously owned by [redacted], subject to a reservation by the New Partnership of the [redacted] for [redacted] years.

In order to obtain the opinion of counsel that, under current federal income tax law, the Partnership will be treated as a partnership in the future, the General Partners must, at all times while acting as general partners of the Partnership, collectively have substantial assets (ignoring their interests in the Partnership and based of fair market values). For this reason, as a part of the Liquidations, the Operating Partnership[5] will distribute certain assets, the fair market value of which exceeds their liabilities by at least $[redacted] to the Special General Partner.[6] The Special General Partner will not pay the Partnership for such assets.

In fact, the [redacted] Property was deeded directly to [redacted] by [redacted]. The taxpayers now claim that the direct transfer of the [redacted] Property to [redacted] served the intended purpose of increasing the net worth of the Special General Partner ([redacted]) while reducing state property transfer taxes[7] and shielding to some extent the assets of the Special General Partner from the New Partnership's creditors.

[redacted] received the $[redacted] cash directly (as provided under the Offer), although [redacted] should have received that $[redacted] cash if [redacted] had contributed [redacted] limited partnership interest to [redacted] as claimed by the taxpayers.

The Taxpayers' Basis in their Old Partnership Interests

Neither [redacted] nor [redacted] were liable for any portion of the liabilities of either of the Old Partnerships. [redacted]'s adjusted basis in its Old Partnership interest at the time of the Transaction was $[redacted]. [redacted] had an adjusted basis in its Old Partnership interest at the time of the Transaction of $[redacted].

Before [redacted] purportedly converted its [redacted] general partnership interest to limited partnership interest and contributed it to [redacted], [redacted] had a combined adjusted basis in its Old Partnership interests (general and limited) of $[redacted] (including its [redacted]% share as general partner of [redacted]'s liabilities of $[redacted]). When [redacted] purportedly converted its general partnership interest then contributed all its limited partnership interest in [redacted] to [redacted] immediately before the exchange of with the New Partnership, it apparently allocated none of the non-liability basis to [redacted], with the result that, according to the taxpayers, [redacted]'s basis in its retained [redacted] general partnership interest was $[redacted] and [redacted]'s basis in its [redacted] limited partnership interest was $[redacted] (the difference between $[redacted] and $[redacted]).

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[5]As part of the overall transaction, New Partnership formed "Operating Partnership," which wound up owning the operating assets previously owned by the Old Partnerships.

[6]The Special General Partner is [redacted].

[7]Only one state property transfer tax was paid ([redacted] to [redacted]) instead of two ([redacted] to [redacted] to [redacted]).

The Bridge Loan

According to the Offer Document, the New Partnership intended to take out a "Bridge Loan" to obtain the $[redacted][8] cash it offered to pay to the partners of the Old Partnerships along with the other consideration offered. The amount of the Bridge Loan was approximately equal to the proceeds received in the public offering, and the repayment of the existing indebtedness (plus financing costs and various fees) was approximately equal to the new debt and a small amount of New Partnership cash on hand, according to the Prospectus:

Sources of Funds		Uses of Funds	
Senior Notes	$[redacted]	Repay old debt	$[redacted]
Acquisition Facility	[redacted]	Financing costs	[redacted]
Cash on hand	[redacted]	Fees & Expenses	[redacted]
Subtotal	$[redacted]	Subtotal	$[redacted]
Public Offering	$[redacted]	Repay Bridge Loan	$[redacted]

The taxpayers assert that pursuant to various agreements between the New Partnership, a bank and a title company, the $[redacted] Bridge Loan would be transferred to the title company which would make the cash payments to the partners of the Old Partnerships. Later, the New Partnership would raise $[redacted] by selling Senior Notes, and would use $[redacted] of those funds to repay the Bridge Loan, with the remainder used to repay old debt (that is, debt the New Partnership had inherited from the Old Partnerships). Also later, the public offering of partnership units would raise $[redacted] which would be used to repay the remainder of the old debt.

Contrary to the taxpayer's representations, under the combined effect of these agreements, the Bridge Loan was intended to be, and was in fact, repaid in full before the title company had any authority to pay the Bridge Loan funds to the members of the Old Partnerships. The proceeds from the public offering and the proceeds from the sale of the Senior Notes were both collected by the bank before any cash payments were made either to the members of the Old Partnerships or to holders of the old debt.

LEGAL ANALYSIS – THE [redacted] TRANSACTION

ISSUE (2) Is the possible application of Internal Revenue Code section 707(a)(2)(B) to the [redacted] Partners transaction a partnership item?

CONCLUSION (2) Yes; however, because that partnership treated the transaction as a disguised sale, the Service can accept that partnership determination and consider in

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[8] $[redacted] to [redacted]; $[redacted] to [redacted]; $[redacted] to [redacted] or [redacted]; and $[redacted] to the other partners of the Old Partnerships.

a partner-level proceeding whether any non-partnership item determinations flow from that partnership determination.

Under the authorities cited and discussed above, particularly Treas. Reg. § 301.6231(a)(3)-1(c)(4), whether section 707(a)(2)(B) applies to a transaction is a partnership item. Since no partnership level proceeding was begun against New Partnership before the expiration of the applicable period of limitations, no adjustments can now be made to partnership items with respect to the Transaction. The Service may, however, make any appropriate non-partnership adjustments or affected items adjustments that flow from the partnership items determined by New Partnership in connection with the Transaction. Roberts v. Commissioner, 94 T.C. 853 (1990).

ISSUE (3) The Bridge Loan or the Senior Notes may not satisfy the requirement of Treas. Reg. § 1.707-5(b) that the partnership "incurs a liability." Is that determination a partnership item?

CONCLUSION (3) Yes. The Service can determine that the Bridge Loan or the Senior Notes fails to satisfy the requirement of Treas. Reg. § 1.707-5(b) that the partnership "incurs a liability" in a partnership proceeding only.

The Service would like to ignore the Bridge Loan entirely as a sham, since the agreements required the purported loan to be repaid before the funds could be paid out; in fact, the purported lender, the bank, was repaid before the title company disbursed any of the so-called loan. Furthermore, the Service would also disregard the Senior Notes for purposes of Treas. Reg. § 1.707-5(b) because the Senior Notes merely refinanced the old debts that New Partnership had inherited from the Old Partnerships. In the Service's view, Treas. Reg. § 1.707-5(b) applies only where the partnership incurs an *additional* liability the funds a distribution to the partners.

In this case, however, New Partnership clearly determined that the Bridge Loan satisfied the requirements of Treas. Reg. § 1.707-5(b). Since Treas. Reg. § 301.6231(a)(3)-1(c)(4) requires New Partnership to determine the amount transferred from the partnership to the partner in a disguised sale transaction, and the character of such an amount, these determinations are partnership items.

ISSUE (4) Assuming the Bridge Loan or the Senior Notes does trigger the application of Treas. Reg. § 1.707-5(b), is the allocation of the liability to the partners a partnership item?

CONCLUSION (4) Yes. Assuming the Bridge Loan or the Senior Notes triggers the application of Treas. Reg. § 1.707-5(b), the amount of the liability allocated to the partners is a partnership item.

The allocation of a liability to the partners under Treas. Reg. § 1.707-5(b) is not specifically mentioned in Treas. Reg. § 301.6231(a)(3)-1(c), but it is sufficiently similar that we believe this determination is also a partnership item. The definition of

partnership items is not limited to the determinations of items that are actually reported on the partnership return or its Forms K-1. As stated in Treas. Reg. § 301.6231(a)(3)-1(b), "The term 'partnership item' includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc."

ISSUE (5) [redacted] on [redacted], converted its [redacted] general partnership interest (except for [redacted]%) into limited partnership interest, and then contributed its entire [redacted] limited partnership interest to its subsidiary [redacted]. The Service views [redacted]'s involvement in the Transaction as so substantial that [redacted] should nevertheless report any income resulting from the proceeds of the Offer received by [redacted]. Does this determination require consideration of any partnership items?

CONCLUSION (5) Yes. In order to figure out its basis in property is receives from partners, New Partnership must determine, among other matters, what entity is transferring the property to it.

As discussed above under ISSUE (1), Treas. Reg. § 301.6231(a)(3)-1(c)(2)(iv) provides that the partnership needs to determine "[t]he basis to the partnership of contributed property (including necessary preliminary determinations, such as the partner's basis in the contributed property)." In the case of the purported contribution of property ([redacted] partnership interest) from [redacted], the initial "necessary preliminary determination" New Partnership had to make was whether the property was truly contributed by [redacted]. Since New Partnership was required to determine whether the [redacted] partnership interest was contributed by [redacted], the Service cannot change New Partnership's determination in a non-partnership proceeding.

ISSUE (6) [redacted] treated its transfer of the [redacted] Property to [redacted] as an independent transaction from [redacted]'s receipt of New Partnership units and cash from New Partnership. Can the Service contest this treatment in a non-partnership proceeding?

CONCLUSION (6) No. [redacted]'s treatment of its transfer of the [redacted] Property to [redacted] is a partnership item.

The Offer contemplated the transfer of the [redacted] Property to [redacted] as a direct part of Transaction (whereby all the interests in the Old Partnerships were exchanged for interests in the New Partnership plus other property, with the [redacted] Property being part of the other property). The taxpayers assert, however, that [redacted] entered into a partial liquidation transaction with [redacted] (whereby a portion of [redacted]'s limited partnership interest in [redacted] was liquidated in exchange for the [redacted] Property) immediately before the main Transaction between the Old Partnerships and the New Partnership. We are not aware of any evidence from the partnership books and records of [redacted] or New Partnership that contradicts the taxpayers' position. Certainly [redacted] had to determine whether it had transferred the [redacted] Property to [redacted] in partial liquidation of [redacted]'s limited partnership interest in [redacted]. Accordingly, [redacted]'s

treatment of its transfer of the [redacted] Property to [redacted] is a partnership item.

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